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PASS TREASURY FOR NIEHUSS AND FRB; AID FOR MICHALOPOULUS

E.O. 11652: N/A

TAGS: OECD, CIEC, EGEN, ETRD, EFIN, EAID, ENRG, EINV

SUBJECT: AD HOC GROUP OF EXPERTS ON DEBT PROBLEMS OF
DEVELOPING COUNTRIES OF THE TEMPORARY WORKING
PARTY OF THE ECONOMIC POLICY COMMITTEE (TWP);
JULY 8-9, 1976

REF: (A) CPE/TWP/A(76), (B) STATE 160431

1. SUMMARY: FIRST DAY OF TWP DEBT EXPERTS MEETING WAS HIGHLIGHTED BY EXPOSITIONS FROM REPRESENTATIVES OF FRANCE (IN CAPACITY AS PRESIDENT OF "PARIS CLUB"), IMF, AND DAC OUTLINING THEIR EXPERIENCE AND VIEWS TO DATE ON DEBT REORGANIZATION PROBLEMS OF LDC'S. US EMPHASIZED DISTINCTION BETWEEN ACUTE DEBT PROBLEMS TO BE DEALT WITH IN CREDITOR CLUBS AND OTHER LONGER TERM BALANCE OF PAYMENTS PROBLEMS IN WHICH DEBT SERVICE AN ELEMENT. SECOND DAY DEVOTED LARGELY TO PREPARATION PRELIMINARY LIST OF CREDITOR CLUB FEATURES. TEXT OF "CHAIRMAN'S WORKING PAPER" FOLLOWS IN PARA 7 BELOW. END SUMMARY.

2. "PARIS CLUB" REP (PEBEREAU, FRENCH MINISTRY OF FINANCE) PRESENTED COGENT OUTLINE OF EXPERIENCE TO DATE IN CREDITOR CLUBS. HIGHLIGHTS HIS PRESENTATION FOLLOW:

(A) PROCEDURES: CREDITOR CLUBS' PROCEDURES ARE BASED ON PRINCIPLE THAT CREDITORS AND DEBTORS CAN MEET FACE TO FACE FOR RESCHEDULING, WITH EACH REORGANIZATION OF DEBT ADJUSTED TO MEET PARTICULAR NEEDS OF DEBTOR COUNTRY SITUATION. IN THIS WAY, DIRECT RELATIONSHIP IS POSSIBLE, PRESERVING PRINCIPLE OF SECURITY OF DEBT CONTRACTS AND MAINTENANCE CREDITWORTHINESS. PARIS CLUB SEEKS TO MAXIMIZE USE OF COMPETENT OUTSIDE ADVICE, INCLUDING IMF, IBRD, OECD AND REGIONAL DEVELOPMENT BANKS. DEBT PROBLEMS CAN THUS BE TREATED IN CONTEXT OF ECONOMIC AND DEVELOPMENT SITUATION OF EACH DEBTOR COUNTRY.

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(B) CONDITIONS AND TERMS: EXAMINATION OF THE "CASE LAW" OF PARIS CLUB INDICATES A PRAGMATIC APPROACH TO TERMS AND CONDITIONS OF RESCHEDULINGS, WITH FOLLOWING CONVERGENCIES:

(I) DEBTOR FACES AN ACUTE DEBT CRISIS WHICH COULD NOT BE SOLVED ON A SHORT-TERM BASIS THROUGH USE OF NORMAL FACILITIES; CONSOLIDATION IS LAST RESORT MEASURE.

(II) DEBT SERVICE MUST BE SIGNIFICANT PART OF BOP PROBLEM OF DEBTOR. SINCE DEBT CONSOLIDATION AFFECTS CREDITWORTHINESS, THIS SOLUTION CAN ONLY BE USED TO SOLVE SEVERE BOP PROBLEMS.

(III) A DEBT RESCHEDULING PRESUPPOSES THE ELABORATION BY THE DEBTOR OF A REALISTIC ECONOMIC RECOVERY PROGRAM USUALY IN THE FRAMEWORK OF A STANDBY AGREEMENT WITH THE IMF.

(III) TECHNICAL ELEMENTS: TECHNICAL ELEMENTS ARE DEFINED ON AN AD HOC BASIS, BASED ON THE CYCLICAL AND STRUCTURAL SITUATION OF THE DEBTOR, ITS CURRENT AND FUTURE PROSPECTS. THERE ARE NO AUTOMATIC RULES.

(A) THE VARIOUS CONDITIONS TAKE FULL ACCOUNT OF THE ECONOMIC RECOVERY PLAN OF DEBTOR WITHIN FRAMEWORK OF IMF STANDBY AGREEMENT.

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(B) THE CONSOLIDATED CREDITS INCLUDE GOVERNMENT LOANS AND GOVERNMENT GUARANTEED COMMERCIAL CREDITS OF MORE THAN ONE YEAR. REORGANIZATION SHOULD APPLY ONLY TO IMPORTANT CREDITORS (MORE THAN \$1 MILLION). AT THE SAME TIME, THE DEBTOR SHOULD ALSO BE ATTEMPTING TO CONSOLIDATE PRIVATE DEBT ON TERMS SIMILAR TO OFFICIAL RESCHEDULING.

(C) CONSOLIDATION NORMALLY APPLIES TO PRECEDING AND CURRENT YEAR, AND PERCENTAGE OF DEBT CONSOLIDATED VARIES AVERAGING ABOUT 80 PERCENT, BUT CAN GO DOWN TO 50 PERCENT. THE SCHEDULE OF REIMBURSEMENT VARIES GREATLY, BUT AVERAGES ABOUT 7 YEARS. THE GRACE PERIODS ALSO VARY, BUT ARE USUALLY 2-3 YEARS. THE INTEREST RATE IS USUALLY NEGOTIATED BILATERALLY RATHER THAN IN THE CLUB. PARIS CLUB REP SUMMARIZED BY SAYING THAT CASE BY CASE APPROACH IS ONLY ONE ADAPTED TO THE PROBLEM. A GLOBAL APPROACH COULD GIVE RISE TO MANY NEW PROBLEMS, AND WOULD ULTIMATELY PLACE IN QUESTION THE CREDITWORTHINESS OF LDC'S IN GENERAL. IT COULD LEAD TO REORIENTATION OF AID EFFORTS TO LDC'S WHEREIN GREAT EFFORT WOULD BE CONCENTRATED ON THOSE COUNTRIES WITH THE LARGEST DEBT. BUT, LARGEST DEBT DOESN'T NECESSARILY MEAN GREATEST NEED.

3. IN BRIEF SUMMARY, IMF REP (WILLIAMS) NOTED THAT IMF TRIES TO HELP LDC'S FORMULATE POLICIES TO AVOID BOP AND DEBT SERVICE PROBLEMS. WHEN PROBLEMS DO ARISE, THEY MUST BE DEALT WITH QUICKLY, WITH AN EFFORT TO IMPROVE THE UNDERLYING CONDITIONS AS WELL. IMF ATTENDS CREDITOR CLUB MEETINGS, PREPARING ANALYSES OF THE ECONOMIC SITUATION AND PROSPECTS OF DEBTOR COUNTRY. THE IMPLEMENTATION OF STABILIZATION PROGRAMS ASSOCIATED WITH RESCHEDULINGS IS MONITORED CAREFULLY BY THE IMF, EITHER WITH OR WITHOUT OFFICIAL STANDBY AGREEMENTS. IMF REP ADVOCATED APPROACHING EACH DEBT SITUATION ON ITS OWN MERITS.

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4. DAC REP (KROLLER) EXPLAINED THAT PAST WORK IN DAC HAS CENTERED IN WORKING PARTY ON THE FINANCIAL ASPECTS OF DEBT (WP/FA). HIS MAIN POINTS WERE:

(A) THE ANALYSIS OF DEBT IS FILLED WITH MISUNDERSTANDINGS AND MISCONCEPTIONS. HE NOTED THAT HAVING DEBT IS NOT NECESSARILY A WEAKNESS; DEBT REPRESENTS THE ECONOMIC COUNTERPART OF THE NET RESOURCES MADE AVAILABLE TO THE DEBTOR. DEBT PROBLEMS ARISE IF FOREIGN CREDITS ARE USED (I) FOR CONSUMPTION OR (II) INVESTED IN PROJECTS WHICH YIELD LESS THAN INTEREST COST OF CREDIT. THUS, DEBT PROBLEMS ARE MERELY BOP PROBLEMS AND ARE SOMETIMES TREATED SEPARATELY BECAUSE THEY ARE CONTRACTUALLY FIXED.

(B) IT HAS BEEN FOUND IMPOSSIBLE TO PREDICT DEBT PROBLEMS THROUGH STATISTICAL DEVICES. AN "EARLY WARNING SYSTEM" IS NOT POSSIBLE BECAUSE THE ECONOMIC INDICATORS ARE NOT AVAILABLE IN TIME, SUCH INDICATORS MAY BE DIFFICULT TO COMBINE, AND THE FIGURES MAY NOT BE RELEVANT.

(C) DEBT APPEARS TO BE RATHER EVENLY DISTRIBUTED AMONG VARIOUS GROUPS OF LDC'S, ALTHOUGH COMMERCIAL DEBT IS CONCENTRATED IN ADVANCED LDC'S.

(D) REMEDIAL ACTION FOR ACUTE DEBT CRISIS: RESCHEDULING IS A LAST RESORT MEASURE, AFTER ALL OTHER BOP MEASURES ARE EXHAUSTED. EACH DEBTOR SHOULD BE TREATED ON A CASE-BY-CASE BASIS, AND THE REORGANIZATION SHOULD TAKE PLACE IN AN ESTABLISHED MULTILATERAL FORUM, E.G. THE CREDITOR CLUBS OR AN IBRD AID CONSORTIUM. STRESS MUST BE PLACED ON SIMULTANEOUS STABILIZATION PROGRAMS UNDERTAKEN BY EACH DEBTOR.

5. IN FOLLOW-UP TO THREE EXPOSITIONS, US DEL (PELIKAN)
GAVE USG VIEWS ON DEBT DISCUSSION, PRESENTING AGAIN THE
DISTINCTION MADE BY USG BETWEEN ACUTE DEBT CRISIS, AND
BALANCE OF PAYMENTS PROBLEMS ARISING FROM THE DEVELOP-
MENT PROCESS, WHICH INCLUDE A DEBT SERVICE ELEMENT. US
DEL SUGGESTED THE FINANCE COMMISSION (FC) IN CIEC CON-
CENTRATE ON THE ACUTE DEBT CRISIS SITUATION AND FEATURES
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COMMON THERETO IN REACTING TO UNCTAD RESOLUTION. THE
PARIS CLUB APPROACH TO ACUTE DEBT CRISIS SITUATIONS
SHOULD BE REAFFIRMED. US DEL ALSO SUGGESTED THAT
DEVELOPMENT COMMISSION (DC) COULD FOCUS ON THE DEVELOP-

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MENT PROCESS, MAXIMIZING UTILIZATION OF EXTERNAL
RESOURCES, QUALITY OF ASSISTANCE AND GRANT ELEMENT OF
DEBT RELIEF PLEDGED IN AID CONSORTIUM. DUTCH, JAPANESE
AND SWISS DELS INDICATED GENERAL AGREEMENT WITH US
VIEWS.

6. CHAIRMAN (VAN YPERSELE) SUMMARIZED FIRST DAY'S DIS-
CUSSION BY SAYING: (A) MOST DELS ACCEPT WITH VARIOUS
DEGREES OF ENTHUSIASM THE DISTINCTION BETWEEN ACUTE DEBT
CRISIS, AND "NON-ACUTE" DEBT SITUATION. (B) FOR ACUTE
DEBT CRISIS, COMMON FEATURES FOR GUIDANCE SHOULD BE
FOUND BASED ON PRESENTATION BY PARIS CLUB REP. (C)
DISCUSSION OF ACUTE DEBT CRISIS BEINGS IN FC.

7. SECOND DAY OF TWP WAS DEVOTED ALMOST EXCLUSIVELY TO
PREPARATION OF "CHAIRMAN'S WORKING PAPER" ON FEATURES
WHICH COULD PROVIDE GUIDANCE FOR ACUTE DEBT CRISIS.
AFTER CONSIDERABLE DEBATE, FINAL VERSION OF PAPER IS IN
ACCORD WITH USG POSITION. TEXT FOLLOWS:

BEGIN TEXT

PRELIMINARY THOUGHTS ON FEATURES OF DEBT REORGANIZATION
OPERATIONS WHICH COULD PROVIDE GUIDANCE IN FUTURE
OPERATIONS RELATING TO ACUTE DEBT SITUATIONS

(CHAIRMAN'S WORKING PAPER)

ONE CAN DISTINGUISH AN ACUTE DEBT CRISIS SITUATION, INVOLVING DEFAULT OR IMMINENT DEFAULT, FROM A SITUATION OF A LONGER-TERM NATURE WHICH HAS TO BE CONSIDERED IN RELATION TO STRUCTURAL PROBLEMS, THE TRANSFER OF RESOURCES AND THE QUALITY AND EFFECTIVE USE OF DEVELOPMENT ASSISTANCE.

THE CHARACTERISTICS OF AN ACUTE DEBT CRISIS SITUATION ARE:

- THE DEBTOR COUNTRY IS FACING DEFAULT, OR IMMINENT LIMITED OFFICIAL USE

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DEFAULT, ON DEBT SERVICING AS WELL AS SERIOUS BALANCE-OF-PAYMENTS DIFFICULTIES IN WHICH DEBT SERVICING PAYMENTS PLAY A MAJOR ROLE.

- THIS SITUATION CANNOT BE REMEDIED, IN THE SHORT TERM, BY APPROPRIATE INTERNAL AND EXTERNAL ADJUSTMENT MEASURES WHICH THE DEBTOR COUNTRY CAN REALISTICALLY BE EXPECTED TO TAKE, AND THEREFORE THERE IS A NEED FOR RECOURSE TO DEBT REORGANIZATION AS A LAST RESORT.

ACUTE DEBT CRISIS SITUATIONS WOULD BE TREATED, ON A CASE BY CASE BASIS, IN THE "CREDITOR CLUBS", AT THE REQUEST OF THE DEBTOR CONCERNED.

TO PROVIDE GUIDANCE FOR DEBT REORGANIZATION IN ACUTE DEBT CRISIS SITUATIONS, SOME OF THE FEATURES WHICH COULD CHARACTERIZE DEBT REORGANIZATION IN SUCH CIRCUMSTANCES ARE SET OUT BELOW:

1) THE DEBTOR COUNTRY WOULD UNDERTAKE A COMPREHENSIVE ECONOMIC PROGRAM DESIGNED TO STRENGTHEN ITS UNDERLYING BALANCE OF PAYMENTS SITUATION. THIS PROGRAM WOULD, AS A GENERAL RULE, BE WORKED OUT WITH, AND MONITORED BY, THE IMF.

2) DEBT REORGANIZATION AND THE PROGRAM OF ECONOMIC MEASURES WOULD TAKE INTO ACCOUNT THE DEVELOPMENT PROSPECTS OF THE DEBTOR COUNTRY, THEREBY ENABLING IT TO CONTINUE DEBT SERVICING PAYMENTS AND RESTORE ITS CREDITWORTHINESS.

3) THE MODALITIES OF DEBT REORGANIZATION WOULD BE DETERMINED FLEXIBLY, ON A CASE BY CASE BASIS, TAKING INTO ACCOUNT, ON THE ONE HAND, THE ECONOMIC SITUATION AND PROSPECTS OF THE DEBTOR COUNTRY, ITS DEVELOPMENT PROGRAM, AND THE FAC-

TORS CAUSING THE DEBT SERVICE DIFFICULTIES AND,
ON THE OTHER HAND, THE LEGITIMATE INTERESTS OF
THE CREDITORS.

4) DEBT REORGANIZATION WOULD COVER OFFICIAL AND
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OFFICIALLY-GUARANTEED DEBT WITH A MATURITY OF
OVER ONE YEAR.

5) CONSOLIDATION PERIODS WOULD NORMALLY BE KEPT

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RELATIVELY SHORT AND GENERALLY WOULD NOT EXTEND,
AS TO FUTURE MATURITIES, BEYOND THE YEAR IN
WHICH THE REORGANIZATION IS UNDERTAKEN.

6) EQUALITY AND NON-DISCRIMINATION AMONG ALL CREDI-
TORS, INCLUDING THOSE NOT PARTICIPATING IN THE
"CREDITOR CLUB", IS AN ESSENTIAL PRINCIPLE
UNDERLYING THE OPERATION OF DEBT RENEGOTIATIONS.
CREDITOR COUNTRIES WITH MINOR DEBTS DUE, WHICH
FREQUENTLY INCLUDE DEVELOPING COUNTRIES, WOULD
GENERALLY, HOWEVER, BE EXCLUDED FROM THE MULTI-
LATERAL DEBT RENEGOTIATION.

7) WITH RESPECT TO ITS PRIVATE NON-OFFICIALLY-
GUARANTEED DEBT, THE DEBTOR COUNTRY IS EXPECTED
TO NEGOTIATE DEBT REORGANIZATION WITH PRIVATE
CREDITORS ON TERMS SIMILAR TO THOSE AGREED IN
THE "CREDITOR CLUB" FOR ITS OFFICIAL AND OFFI-
CIALLY-GUARANTEED DEBT.

8) DEBT REORGANIZATION ARRANGEMENTS WOULD PROVIDE
FOR FLEXIBILITY TO REVIEW THE SITUATION AT THE
END OF THE CONSOLIDATION PERIOD IN THE LIGHT OF
UNFORESEEN CIRCUMSTANCES. THEY WOULD ALSO PRO-
VIDE FOR ACCELERATED REPAYMENTS IN AN AGREED
MANNER IF THE DEBTOR'S ECONOMIC SITUATION
IMPROVES MORE RAPIDLY THAN ANTICIPATED.

END TEXT

ESPECIALLY HELPFUL IS THE DEFINITION OF THE TWO DEBT SITUATIONS, ALTHOUGH THIS DEFINITION WAS NOT ACCEPTED BY THE SWEDISH DELEGATE.

8. TWP MEMBERS EXPRESSED HOPE THAT ACUTE DEBT CRISIS SITUATION COULD BE HANDLED IN FC, AND OTHER SITUATIONS IN THE DEVELOPMENT COMMISSION. THERE WAS CONSIDERABLE SENTIMENT FAVORING TWP FOR BACK-UP ROLE FOR BOTH. VAN YPERSELE EMPHASIZED THAT IT WAS NOT UP TO TWP TO DETERMINED OFFICIAL USE

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MINE PROCEDURE FOR BACK-UP. THIS WOULD HAVE TO BE DECIDED IN OECD COUNCIL OR OTHER APPROPRIATE INTERNAL MEANS. GENERAL FEELING WAS THAT OECD PREPARATION FOR DEBT SHOULD BE DONE IN THE MOST UNIFIED WAY POSSIBLE.

9. TWP AGREED ON TENTATIVE "CONTINGENCY" BASIS TO CON- VENE DRAFTING GROUP ON SEPTEMBER 7 AND 8 TO ADDRESS FURTHER THE "FEATURES" WHICH WOULD GUIDE CREDITOR CLUB OPERATIONS AND TO PREPARE PAPER ON DEBT CONSOLIDATION AS A TOOL IN AID CONSORTIUMS. FULL EXPERTS GROUP OF TWP WOULD MEET SEPTEMBER 9 AND 10 TO SEE IF COMMON PAPER MIGHT BE AGREED FOR PRESENTATION IN THE CIEC. CONFIRMA- TION OF MEETINGS WILL OCCUR AFTER CIEC HAS DETERMINED DISTRIBUTION OF WORK ON DEBT AS BETWEEN FC AND DC AND AFTER DECISION IS MADE IN OECD ON WHICH GROUP WILL DO BACKSTOPPING ON DEBT ASPECTS TO BE CONSIDERED IN DC. KATZ

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Disposition Date: 28 MAY 2004
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